

Message Text

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ACTION ARA-14

INFO OCT-01 ISO-00 AID-05 CIAE-00 COME-00 EB-08 FRB-03
INR-10 NSAE-00 ICA-11 TRSE-00 XMB-02 OPIC-03
SP-02 LAB-04 SIL-01 OMB-01 NSC-05 SS-15 STR-07
CEA-01 PA-01 DOE-15 SOE-02 AGRE-00 /111 W
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R 221339Z JUN 78
FM AMEMBASSY MANAGUA
TO SECSTATE WASHDC 6924
INFO AMEMBASSY GUATEMALA
AMEMBASSY SAN JOSE
AMEMBASSY SAN SALVADOR
AMEMBASSY TEGUCIGALPA

LIMITED OFFICIAL USE SECTION 1 OF 2 MANAGUA 2859

GUATEMALA ALSO FOR ROCAP

E.O. 11652: N/A
TAGS: EAID, EFIN, ENRG, PINT, IMF, NU
SUBJECT: ECONOMIC ASPECTS OF PRESIDENT SOMOZA'S JUNE 19 PRESS

REF: A) MANAGUA 2817, B) MANAGUA 2757 (NOTAL)

BEGIN SUMMARY: SOMOZA CLAIMED, OVERLY OPTIMISTICALLY, THAT NICARAGUA'S PRESENT ECONOMIC SITUATION IS BETTER THAN LAST YEAR'S BUT ADMITTED THAT THINGS ARE GOING TO GET TOUGHER. HE HINTED AT INCREASED DOMESTIC TAXES, BUT REJECTED EXPORT TAXES WHICH THE IMF REPOR-

TEDLY RECOMMENDS. HE BLAMED LOCAL PRIVATE BANKS FOR NICARAGUA'S PRESENT LIQUIDITY CRISIS AND SEEMED TO CALL FOR A GREATER PUBLIC SECTOR ROLE IN THE ECONOMY. THE GON, HE SAID, IS MOVING AHEAD TO RESOLVE THE NATION'S ENERGY CRISIS THROUGH VARIOUS MEANS; ALL THAT IS NEEDED IS MONEY. IT IS UNCLEAR WHETHER THE FISCAL MEASURES SOMOZA CONTEMPLATES WILL SATISFY THE IMF'S REQUIREMENTS FOR A STANDY-BY
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AGREEMENT. WHILE WE DO NOT KNOW WHAT MEASURES THE GON WILL ADOPT, THEY WILL PROBABLY REDUCE DOMESTIC CONSUMPTION AND MAY INCLUDE IMPORT RESTRICTIONS. END SUMMARY.

1. DURING HIS JUNE 19 PRESS CONFERENCE -- POLITICAL ASPECTS OF WHICH ARE NOTED IN REF A -- PRESIDENT SOMOZA MADE FOLLOWING ECONOMIC-RELATED COMMENTS IN HIS OPENING REMARKS:

(A) NICARAGUA WAS FINANCIALLY AT THE "BOTTOM OF THE BARREL" IN 1969 WHEN THE GON INITIATED FISCAL REFORMS DESIGNED TO STIMULATE THE ECONOMY. THAT ECONOMY HAS GROWN FROM \$400 PER CAPITA IN 1969 TO ALMOST \$1,000 IN 1977. THE BASE FOR TAX COLLECTION SHOULD NOW BE ADJUSTED TO REFLECT THIS CHANGE. THE GON NEEDS GREATER TAX REVENUES TO MEET ITS CITIZENS' JUST DEMANDS.

(B) THE GON SHOULD REVIEW COMPLETELY THE BENEFITS IT DERIVES FROM THE CENTRAL AMERICAN COMMON MARKET (CACM) AND FROM ITS FISCAL INCENTIVES FOR INDUSTRY, AND SHOULD CONSIDER OTHER MEASURES WHICH MIGHT INCREASE PUBLIC SECTOR "PARTICIPATION" IN NICARAGUA'S GROSS DOMESTIC PRODUCT (GDP). THE RATIO ON GON TAX REVENUES TO GDP (10.38 PERCENT) IS LOWER THAN IN ANY OTHER CACM COUNTRY, HE NOTED. (SOMOZA LATER ADDED THAT HE WAS NOT CONTENT WITH NICARAGUA'S SITUATION VIS-A-VIS THE CACM AND THAT HE WOULD SEEK A "REAL EQUITY" WHEREBY NICARAGUANS WOULD NOT LOSE JOBS.)

(C) THE REASON WHY NICARAGUA'S PUBLIC SECTOR REVENUE RATIO TO GDP IS SO LOW IS THAT "MY GOVERNMENT HAS NEVER TAXED AGRICULTURAL PRODUCTION AS OTHER GOVERNMENTS HAVE DONE. THIS DOES NOT MEAN THAT WE HAVE TO PUSH AHEAD AS FAST AS THE REST OF THE REGION. THUS WE ARE GOING TO MAKE A REVIEW OF WHICH TAXES WILL BE LEVIED ON NONESSENTIALS WITHOUT DISRUPTING EXPORT PRODUCTION UPON WHICH NICARAGUA'S PRESENT PROGRESS IS BASED." (SOMOZA LATER ELABORATED SLIGHTLY BY HINTING THAT LUXURIES, WHICH HE DEFINED AS ANYTHING NOT NECESSARY FOR LIFE, WILL BE TAXED AND THAT CONSUMERS' DEMAND MAY BE REDUCED LIMITED OFFICIAL USE

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THROUGH HIGHER TAXES, INCLUDING EXCISES.)

(D) "NEITHER DO I WANT THE GOVERNMENT TO TAKE OVER SUCH A LARGE PERCENTAGE OF GDP THAT THERE WOULD BE NO ROOM FOR PRIVATE SECTOR GROWTH."

(E) CALIFORNIA'S ADOPTION OF PROPOSITION 13 WILL, HE OPINED, VERY PROBABLY MEAN THAT U.S. AID TO NICARAGUA WILL DECREASE, THUS FORCING "US TO TAX OURSELVES MORE, TO MAKE A GREATER INTERNAL EFFORT. THEREFORE, I CONSIDER IT TIME FOR US NICARAGUANS TO BEGIN TO SEE HOW WE CAN SET OUR HOUSE IN ORDER SO AS TO HAVE SUSTAINED DEVELOPMENT...."

2. IN RESPONDING TO QUESTIONS AFTER HIS OPENING REMARKS, SOMOZA SAID:

(A) NICARAGUA'S PRIVATE SECTOR, IS, IN GENERAL, BETTER OFF ECONOMICALLY THIS YEAR THAN LAST. THE PUBLIC SECTOR NEEDS MORE TAXES TO MEET INCREASED DEMAND FOR SERVICES AND "WE HAVE TO SEE HOW TO ARRANGE THIS. ECONOMICALLY, NICARAGUA IS BETTER OFF THAN LAST YEAR." (COMMENT: CENTRAL BANK OFFICIAL COMMENTED TO EMBOFF JUNE 20 THAT SOMOZA IS OUT OF TOUCH WITH REALITY IF HE THINKS NICARAGUA'S ECONOMY HAS IMPROVED OVER LAST YEAR. THE CONTRARY IS THE CASE, HE CONFIDED, AND

THE EMBASSY TENDS TO AGREE-SEE REF B).

(B) IN RESPONDING TO A QUESTION AS TO WHY PRIVATE LOCAL BANKS ARE NOT LOANING MONEY FOR BUSINESS, COMMERCE, INDUSTRY OR AGRICULTURE AT PREVIOUS YEAR'S LEVELS-NOTWITHSTANDING SOMOZA'S EARLIER CLAIM THAT THERE HAS BEEN NO FLIGHT OF CAPITAL, SOMOZA REPLIED THAT "THIS IS DUE FUNDAMENTALLY TO THE PECULIAR ATTITUDE OF THE BANKS' DIRECTORS." (COMMENT: SOMOZA SEEMED RELUCTANT TO ADMIT THAT NICARAGUA IS FACTING A LIQUIDITY CRISIS AND THAT GON POLICIES ARE PARTIALLY TO BLAME.) (SEE REF B).

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(C) RE ENERGY, SOMOZA INDICATED THAT THE MOMOTOMBO GEOTHERMAL PLANTS WILL SAVE NICARAGUA \$25 MILLION ANNUALLY IN PETROLEUM IMPORTS. CANA BRAVA (A TYPE OF BAMBOO) WILL BE USED AS A FUEL TO PRODUCE 1,000 KW OF POWER FOR A CEMENT CLINKER GRINDING PLANT AT RAMA. NOTHING HAS BEEN DECIDED YET ABOUT WHETHER TO PROCEED FIRST WITH THE OPALAR OR THE BRITO HYDROELECTRIC PLANT EACH HAS EQUAL PRIORITY. BOTH WILL

MOVE AHEAD OVER THE NEXT TEN YEARS IF FINANCING CAN BE FOUND.

(D) AN OFFSHORE TEXACO OIL-DRILLING RIG WHICH SOMOZA VISITED RECENTLY HAS ENCOUNTERED SOME PROMISING SUBSTRATE IN THE CARUBBEAN. IT IS NOT YET KNOWN, HOWEVER, WHETHER OIL EXISTS IN COMMERCIALY EXPLOITABLE QUANTITIES.

(E) THE GOVERNMENT WILL STRIVE FOR COMPARABILITY OF ITS EMPLOYEES' INCOME WITH THAT OF PRIVATE SECTOR EMPLOYEES, BUT NOT NECESSARILY SOLELY IN MONETARY TERMS.

(F) SOMOZA ISSUED A DECREE LAW DURING THE LEGISLATURE RECESS, WHICH LIMITED OFFICIAL USE

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TRANSFERRED FUNDS TO THE NATIONAL HOUSING BANK (BAVINIC) TO COVER SOME OF THE LATTER'S DEBTS. (COMMENT: THE TRANSFER AMOUNTED TO ABOUT \$32 MILLION).

3. COMMENT: WE UNDERSTAND THAT THE IMF IS PUSHING THE GON TO TAX WINDFALL PROFITS ON EXPORT COMMODITIES, SUCH AS MEAT, COTTON AND COFFEE. SOMOZA'S REMARKS INDICATE THAT THE GON REMAINS RELUCTANT TO TAX THE EXPORT SECTOR. RATHER, SOMOZA HINTS STRONGLY AT INCREASED DOMESTIC TAXES AND MAY RESORT TO SOME IMPORT RESTRICTIONS, PARTICULARLY OF NON-PRODUCTIVE OR NONESSENTIAL GOODS. AS FORESHADOWED IN PARA 4, REF B, WE BELIEVE THAT SOMOZA IS BEING FORCED TO REVERSE HIS PAST OPPOSITION TO NEW TAXES, POSSIBLY IN RESPONSE TO IMF PRESSURE FOR AN EFFECTIVE FISCAL STABILIZATION POLICY. MEANWHILE, WE UNDERSTAND THAT THE GON MAY INCREASE ITS DOMESTIC SALES TAX FROM SIX TO EIGHT PERCENT NEXT MONTH. TOTAL SALES TAXES WOULD REACH TEN PERCENT SINCE ANOTHER TWO PERCENT IS ADDED TO FINANCE SOCIAL SERVICES.

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